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**MEMORANDUM**REC'D  
AZ CORP COMMISSION  
DOCKET CONTROL

2014 MAR 21 PM 2 09

TO: Docket Control

FROM: Steven M. Olea  
Director  
Utilities Division

Date: March 21, 2014

**ORIGINAL**

RE: IN THE MATTER OF THE APPLICATION OF SOUTH CENTRAL UTAH TELEPHONE ASSOCIATION, INC. FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER.  
(DOCKET NO. T-01923A-13-0428)

Attached is the Staff Report for South Central Utah Telephone Association, Inc. dba South Central Communications' Application to increase residential rates to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

Staff recommends approval of South Central Utah Telephone Association, Inc. dba South Central Communications' request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC.

SMO: PJG:tdp\MAS

Originator: Pamela J. Genung

Arizona Corporation Commission

**DOCKETED**

MAR 21 2014

DOCKETED BY

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DOCKET NO.: T-01923A-13-0428

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STAFF REPORT  
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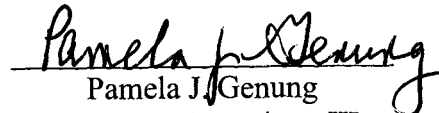
SOUTH CENTRAL UTAH TELEPHONE ASSOCIATION, INC.  
DOCKET NO. T-01923A-13-0428

IN THE MATTER OF THE APPLICATION OF SOUTH CENTRAL UTAH TELEPHONE  
ASSOCIATION, INC. FOR A HEARING TO DETERMINE THE EARNINGS OF THE  
COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES,  
AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR  
THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER

March 21, 2014

## STAFF ACKNOWLEDGMENT

The Staff Report for South Central Utah Telephone Association, Inc. dba South Central Communications, Docket No. T-01923A-13-0428, was prepared by the Staff member shown below.

  
Pamela J. Genung  
Executive Consultant III

**EXECUTIVE SUMMARY**  
**SOUTH CENTRAL UTAH TELEPHONE ASSOCIATION, INC.**  
**DOCKET NO. T-01923A-13-0428**

On December 9, 2013, South Central Utah Telephone Association, Inc. dba South Central Communications ("SCC" or "Applicant") filed an Application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased as necessary to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, USF/ICC Transformation Order ("USF/ICC Order"); pursuant to Arizona Revised Statute ("A.R.S.") § 40-250.

Staff recommends that the SCC monthly residential local exchange rate increase from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to SCC pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increases; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff further recommends that any future rate increase applications filed by SCC be processed per full A.A.C. R14-2-103 requirements, not streamlined.

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## **INTRODUCTION**

On December 9, 2013, South Central Utah Telephone Association, Inc. dba South Central Communications (“SCC” or “Applicant”) filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased as necessary to compensate for the rate impacts of the Federal Communication Commission’s (“FCC’s”) November 18, 2011, USF/ICC Transformation Order (“USF/ICC Order”) pursuant to Arizona Revised Statute (“A.R.S.”) § 40-250. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. SCC submitted a streamlined filing containing the following five exhibits to support the requested increase in residential rates:

- Regulated Results of Operations Twelve Months Ending September 30, 2013
- Rate Base as of September 30, 2013
- Cash Working Capital
- Proposed Rate Design
- Estimated ICC Impact of FCC Order

On December 16, 2013, the Applicant filed a Notice of Errata to correct an error in its December 9, 2013 Application.

On December 17, 2013, the Applicant filed a Time Clock Waiver for thirty (30) days.

On January 29, 2014, the Applicant filed a Supplemental Filing.

## **BACKGROUND**

SCC is a non-profit association duly organized and existing under and by virtue of the laws of the State of Utah. SCC is authorized to engage in and is now engaged in the conduct of a general communications business within the State of Arizona. SCC is a small rate-of-return (“RoR”) regulated incumbent local exchange carrier (“ILEC”).

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund (“CAF”). The FCC’s press release characterized the USF/ICC Order as “the most significant policy step ever taken to connect all Americans to broadband.”

In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The recovery from the CAF for the reduction in ICC rates will phase out over time at 5 percent annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support (“FHCLS”) to carriers by the amount their flat-rate residential local

service rates fall below a specified annual rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC's order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as of June 1, 2013, with the floor thereafter being determined annually by the FCC's Wireline Competition Bureau, based on a nationwide average. To date, the Wireline Competition Bureau has not determined the rate floor to be in effect for June 1, 2014. The FCC is conducting a survey of urban rates for fixed voice residential services, required by the USF/ICC Order. The information collected in this survey will be used to establish a rate floor for voice services that eligible telecommunications carriers ("ETCs") receiving high cost loop support ("HCLS") or frozen high-cost support must meet in order to receive their full support amounts.

To maintain FHCLS, SCC and other rural ILECs must increase single line residential local rates to the FCC-mandated residential rate floors. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line local rate and the new rate floor.

The Arizona Corporation Commission's ("Commission's") last considered SCC's rates in Docket No. T-01923A-13-0229, which resulted in Commission Decision No. 74205<sup>1</sup>, dated December 3, 2013. With this application, SCC seeks Commission approval to raise its residential local service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

### **CONSUMER SERVICES**

On December 17, 2013, the Records Section of the Corporations Division responded that SCC is in good standing. A review of the Consumer Services database revealed that no complaints, inquiries and opinions were received pertaining to SCC for the period January 1, 2010 through December 17, 2013.

### **PUBLIC NOTICE**

On March 3, 2014, SCC provided Staff with a copy of the Notice that SCC sent to its Arizona residential customers on February 12, 2014. On March 10, 2014, SCC filed an Affidavit of Customer Notice indicating that the required notice was sent on February 12, 2014 to SCC's Arizona residential customers of record.

### **COMPLIANCE**

A check of the Utilities Division Compliance Section database showed that SCC is in compliance with all items.

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<sup>1</sup> Decision No. 74205 authorized SCC to raise its residential service rates to \$14.00/month, effective December 1, 2013.



### **OPERATING INCOME STATEMENT**

SCC submitted Regulated Results of Operations for Twelve Months Ending September 30, 2013 in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined Application.

#### *Operating Revenue and Expenses*

According to the information provided by the Applicant, SCC Total Intrastate Operating Revenues for the Twelve Months Ending September 30, 2013 were \$433,598. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$262,507
Intrastate	\$150,671
Miscellaneous	\$ 4,220
Uncollectible	\$ 16,200

The Applicant also stated that its Total Intrastate Operating Expenses for the Twelve Months Ending September 30, 2013 were \$423,100. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Specific Operations	\$ 90,814
Plant Non-specific Operations	\$ 4,845
Depreciation	\$186,766
Marketing	\$ 14,898
Customer Operations	\$ 55,383
Corporate Operations	\$ 70,394

#### *Operating Income*

As provided by the SCC's Total Intrastate Operating Income for the Twelve Months Ending September 30, 2013 was \$10,499 before taxes and negative \$58,497 after taxes.

### **RATE BASE**

According to SCC, the interstate and intrastate rate base is \$1,374,664, as stated in the table below:

**South Central Utah Telephone Association, Inc.  
Rate Base as of September 30, 2013**

	Total Company	Interstate	Intrastate
Plant In Service	\$ 7,496,458	\$ 3,336,066	\$ 4,160,392
<i>Accumulated Depreciation</i>	<u>6,266,701</u>	<u>3,007,164</u>	<u>3,259,537</u>
Net Plant in Service	\$ 1,229,757	\$ 328,902	\$ 900,855
Plant Under Construction	(28,245)	(12,569)	(15,676)
Material & Supplies	-	-	-
Deferred Income Taxes	-	-	-
Other Long Term Liabilities	133,383	59,358	74,025
Customer Deposits	4,750	2,114	2,636
Cash Working Capital	<u>35,019</u>	<u>16,130</u>	<u>18,889</u>
Rate Base	\$ 1,374,664	\$ 393,935	\$ 980,729

### **CUSTOMER BASE**

SCC reported 653 residential lines and 345 business lines in its Utilities Annual Report received April 22, 2013.

### **REVENUE REQUIREMENT**

As stated above, the Applicant's filing was based on streamlined requirements to meet the FCC's deadline for federal USF funding. Therefore, the Applicant's filing does not contemplate rate adjustments based on a typical revenue requirement analysis.

### **RATE DESIGN**

The Applicant is seeking to increase its residential local exchange service rate up to \$19.00. The actual rate implemented would be set at the lesser of the approved 2014 local service rate floor or \$19.00. SCC indicated that it will file the new FCC rate floor as soon as it is available. The Applicant's filing only contemplates changes to residential local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residential local exchange service rates from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

## **STAFF ANALYSIS**

Staff did not perform a regulatory audit of the information submitted by SCC. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order, which is intended to transition the outdated federal universal service programs and certain intercarrier compensation reductions into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter, the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base ("FVRB"). The Applicant states that its intrastate rate base is \$980,729. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for the Twelve Months Ending September 30, 2013 was \$433,598.

According to the Applicant, the annual revenue effect of the increase in residential local telephone service rates to \$19.00 is \$39,205.<sup>2</sup> SCC's return on rate base is negative and would remain negative with the \$19.00 rate. In the Applicant's Supplemental Filing, SCC indicated that the annual revenue effect of the increase in residential local telephone service rates to \$17.50 is \$27,444.<sup>3</sup> At the \$17.50 residential local service rate, SCC's return on rate base would be negative. Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and any impact on the Applicant's FVRB would be de minimus.

## **STAFF'S RECOMMENDATIONS**

Staff recommends approval of SCC's request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC.<sup>4</sup> Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to SCC pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increases; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

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<sup>2</sup> Based on 654 one-party residential lines.

<sup>3</sup> Based on 654 one-party residential lines.

<sup>4</sup> The rate floor compliance date is the date (currently June 1) on which the local service rate must equal or exceed the FCC rate floor so a company receiving federal high-cost loop support may continue to receive all of its authorized Federal Universal Service Fund revenues.

Staff further recommends that any future rate increase applications filed by SCC be processed per full A.A.C. R14-2-103 requirements, not streamlined.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique circumstances should not be viewed as precedent for the processing of future rate case applications.